Agenda item: _______

Decision maker:	Cabinet City Council
Subject:	Treasury Management Mid Year Review for 2012/13
Date of decision:	15 November 2012 (Governance, Audit & Standards Committee – Information only) 3 December 2012 (Cabinet) 11 December 2012 (City Council)
Report by:	Chris Ward, Head of Financial Services and Section 151 Officer
Wards affected:	All

Key decision: No
Budget & policy framework decision: Yes

---

1. Summary

The Chartered Institute of Public Finance and Accountancy (CIPFA) defines Treasury Management as "The management of the organisation's cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks". The risks associated with Treasury Management include credit risk, liquidity risk, interest rate risk and refinancing risk. The report contained in Appendix A reports on the City Council's treasury management position as at 30 September 2012. Appendix B contains proposed changes to the Council's approved investments.

2. Purpose of report

The purpose of the report is to inform members and the wider community of the Council's Treasury Management position at 30 September 2012 and of the risks attached to that position, and to revise the list of approved investments.

3. Recommendations

(1) That the following actual Treasury Management indicators for the second quarter of 2012/13 be noted:

(a) The Council's net debt at 30 September 2012 was:

	Limit £m	Actual £m
Gross Debt - Maximum	484	464
Investments - Minimum	(212)	(258)
Net Debt	272	206

(b) The Council's debt at 30 September was as follows:

Prudential Indicator 2012/13	Limit £M	Position at 30/9/12 £M
Authorised Limit	508	464
Operational Boundary	484	464

(c) The maturity structure of the Council's borrowing was:

	Under 1 Year	1 to 2 Years	3 to 5 Years	6 to 10 Years	11 to 20 Years	21 to 30 Years	31 to 40 Years	41 to 50 Years
Lower Limit	0%	0%	0%	0%	0%	0%	0%	0%
Upper Limit	6%	6%	18%	30%	60%	60%	60%	80%
Actual	1%	4%	3%	5%	9%	12%	8%	58%

(d) The Council's interest rate exposures at 30 September 2012 were:

	Limit £m	Actual £m
Fixed Interest	378	252
Variable Interest	(378)	(150)

(2) That the limits on the Council's sums invested for periods longer than 364 days be revised as follows:

Maturing after	Original Limit £m	Recommended Revised Limit £m	Actual £m
31/3/2013	110	150	106
31/3/2014	90	90	35
31/3/2015	80	80	15

(3) That the investment limit applied to building societies be increased by £50m from £28m to £78m.

(4) That the revised list of investment counter parties and limits in Appendix B be approved.

(5) That the limit on non-specified investments be increased by £90m from £146m to £236m.

4. Background

CIPFA's Treasury Management Code requires a Treasury Management Mid Year Review to be considered by the City Council. The reports in Appendix A covers the first six months of 2012/13.

5. Reasons for Recommendations

The Annual Investment Strategy for 2012/13 raised the individual counter party limits from 364 days to 366 days. It was felt that financial institutions may prefer 366 day investments as they are beneficial to them in meeting financial regulations and that this may provide a means of increasing investment returns without significantly increasing credit and liquidity risk. This has proved to be attractive to financial institutions and the Council will have £106m invested for periods longer than 364 days at 31 March 2013 compared to a limit of £110m. It is therefore recommended that the limit on principal sums invested for periods longer than 364 days at 31 March 2013 be increased by £40m to £150m.

The Council has had difficulty finding sufficient suitable banks and building societies to invest its surplus funds with. Consequently at 30 September 46% of the Council's investments were placed with other local authorities which are currently offering less than 0.5% for an investment of a year's duration. The interest rates offered by the Council's current approved counter parties are not expected to increase in the near future.

It is therefore recommended that the number of approved institutions where investments can be placed be increased, principally through the inclusion of unrated building societies. Many smaller building societies that have been conservative in their lending approach do not have credit ratings. The mutual ownership of building societies means that in the unlikely event of a building society failing, wholesale depositors such as the Council would almost certainly receive back the full amount of their investment, with any losses falling on the society's reserves and members' deposits first. If the credit worthiness of an unrated building society changed this would not be communicated by the credit rating agencies. However building societies operate under a separate legal regime to banks, which limits the amount of lending not secured on residential property and limits the amount of wholesale funding.

The Council requires financial institutions to have a credit rating of at least A- to be included in the list of specified investments. Therefore unrated building societies will be non-specified investments and the limits on non specified investments will need to be increased to accommodate them. Similarly the limit applied to the building society sector will also need to be increased.

It is proposed to lower the required sovereign rating for the countries where banks are located from AAA to AA+. Two of the three main credit rating agencies have put the UK's sovereign AAA rating on negative outlook so it would be appropriate to lower the required sovereign rating to AA+. The principle effect of this is to include American banks on the approved list of investments.

It is proposed to exclude banks located in the Euro zone from the proposed list of approved investments due to the considerable economic and political uncertainty in the region. Although the countries receiving or likely to require bail outs are confined to the periphery of the Euro zone, further bail outs or stronger measures such as debt guarantees could weaken the core countries that would bear the brunt of financing these.

6. Options considered and rejected

Returns could also be improved by increasing the duration of investments or increasing investment limits with individual institutions.

Increasing the duration of investments would not be prudent given the current economic and political uncertainties in the world which could affect the credit worthiness of financial institutions over time. This is evidenced by the fact that most financial institutions have had their credit ratings cut over the last few years and some have even required government rescues.

The maximum approved individual investment limits are up to £20m, with the exception of the UK government which is unlimited. A loss on this scale would have severe consequences on the Council's finances and it would not be prudent to increase the investment limits further.

7. Implications

The net cost of Treasury Management activities and the risks associated with those activities have a significant effect on the City Council's overall finances. Effective Treasury Management provides support to the organisation in the achievement of its business and service objectives.

8. Equality impact assessment (EIA)

A preliminary equalities impact assessment on Treasury Management Policy has been carried out.

9. City Solicitor's Comments

The Section 151 Officer is required by the Local Government Act 1972 and by the Accounts and Audit Regulations 2011 to ensure that the Council's budgeting, financial management, and accounting practices meet the relevant statutory and professional requirements. Members must have regard to and be aware of the wider duties placed on the Council by various statutes governing the conduct of its financial affairs.

10. Head of Finance's comments

All financial considerations are contained within the body of the report and the attached appendices

....

Signed by Head of Financial Services & Section 151 Officer

Appendices:

Appendix A: Treasury Management Mid Year Review 2012/13
Appendix B: Investment Counter Party List

Background list of documents: Section 100D of the Local Government Act 1972

The following documents disclose facts or matters, which have been relied upon to a material extent by the author in preparing this report:

	Title of document	Location
1	Treasury Management Files	Financial Services
2		

The recommendation(s) set out above were approved/ approved as amended/ deferred/ rejected by the Cabinet on 3 December 2012.

....

Signed by: Leader of the Council

APPENDIX A

TREASURY MANAGEMENT MID YEAR REVIEW OF 2012/13

1. GOVERNANCE

The Treasury Management Policy Statement, Annual Minimum Revenue Provision for Debt Repayment Statement and Annual Investment Strategy approved by the City Council on 20 March 2012 provide the framework within which Treasury Management activities are undertaken.

2. ECONOMIC UPDATE

Economic Performance to Date

Economic sentiment, in respect of the prospects for the UK economy to recover swiftly from recession, suffered a major blow in August when the Bank of England substantially lowered its expectations for the speed of recovery and rate of growth over the coming months and materially amended its forecasts for 2012 and 2013. It was noted that the UK economy is heavily influenced by worldwide economic developments, particularly in the Euro zone, and that on-going negative sentiment in that area would inevitably permeate into the UK's economic performance.

With regard to the Euro zone, investor confidence remains weak because successive "rescue packages" have first raised, and then disappointed, market expectations. However, the uncertainty created by the continuing Euro zone debt crisis is having a major effect in undermining business and consumer confidence not only in Europe and the UK, but also in America and the Far East/China.

In the UK, consumer confidence remains very depressed with unemployment concerns, indebtedness and a squeeze on real incomes from high inflation and low pay rises, all taking a toll. Whilst inflation has fallen considerably (CPI @ 2.6% in July), UK GDP fell by 0.5% in the quarter to 30 June, the third quarterly fall in succession. This means that the UK's recovery from the initial 2008 recession has been the worst and slowest of any G7 country apart from Italy (G7 = US, Japan, Germany, France, Canada, Italy and UK). It is also the slowest recovery from a recession of any of the five UK recessions since 1930 and total GDP is still 4.5% below its peak in 2008.

This weak recovery has caused social security payments to remain elevated and tax receipts to be depressed. Consequently, the Chancellor's plan to eliminate the annual public sector borrowing deficit has been pushed back further into the future. The Monetary Policy Committee has kept Bank Rate at 0.5% throughout the period while quantitative easing was increased by £50bn to £375bn in July. In addition, in June, the Bank of England and the Government announced schemes to free up banking funds for business and consumers.

On a positive note, despite all the bad news on the economic front, the UK's sovereign debt remains one of the first ports of call for surplus cash to be invested in and gilt yields, prior to the ECB bond buying announcement in early September, were close to zero for periods out to five years and not that much higher out to ten years.

Outlook for the Next Six Months of 2012/13

The risks in economic forecasts continue unabated. Concern has been escalating that the Chinese economy is heading for a hard landing, rather than a gentle slowdown, while America is hamstrung by political deadlock which prevents a positive approach to countering weak growth. Whether the presidential election in November will remedy this deadlock is debatable but urgent action will be required early in 2013 to address the US debt position. However, on 13 September the Fed announced an aggressive stimulus program for the economy with a third round of quantitative easing focused on boosting the stubbornly weak growth in job creation, and this time with no time limit. They also announced that it was unlikely that there would be any increase in interest rates until at least mid 2015.

Euro zone growth will remain weak as austerity programs in various countries curtail economic recovery. A crunch situation is rapidly developing in Greece as it has failed yet again to achieve deficit reduction targets and so may require yet another (third) bail out. There is the distinct possibility that some of the northern European countries could push for the ejection of Greece from the Euro zone unless its financial prospects improve, which does not seem likely at this juncture. A financial crisis was also rapidly escalating over the situation in Spain. However, in early September the ECB announced that it would purchase unlimited amounts of shorter term bonds of Euro zone countries which have formally agreed the terms for a bailout. Importantly, this support would be subject to conditions (which have yet to be set) and include supervision from the International Monetary Fund. This resulted in a surge in confidence that the Euro zone has at last put in place the framework for adequate defences to protect the Euro. However, it remains to be seen whether the politicians in charge of Spain and Italy will accept such loss of sovereignty in the light of the verdicts that voters have delivered to the politicians in other peripheral countries which have accepted such supervision and austerity programs. The Euro zone crisis is therefore far from being resolved as yet. The immediate aftermath of this announcement was a rise in bond yields in safe haven countries, including the UK. Nevertheless, this could prove to be as short lived as previous "solutions" to the Euro zone crisis.

The Bank of England Quarterly Inflation Report in August pushed back the timing of the return to trend growth and also lowered its inflation expectations. Nevertheless, concern remains that the Bank's forecasts of a weaker and delayed robust recovery may still prove to be over optimistic given the world headwinds the UK economy faces. Weak export markets will remain a drag on the economy and consumer expenditure will continue to be depressed due to a focus on paying down debt, negative economic sentiment and job fears. The Government, meanwhile, is likely to be hampered in promoting growth by the requirement of maintaining austerity measures to tackle the budget deficit.

The overall balance of risks is, therefore, weighted to the downside:

- The Council's consultants, Sector, expect low growth in the UK to continue, with Bank Rate unlikely to rise in the next 24 months, coupled with a possible further extension of quantitative easing. This will keep investment returns depressed.
- The expected longer run trend for PWLB borrowing rates is for them to eventually rise, primarily due to the need for a high volume of gilt issuance in the UK and the high volume of debt issuance in other major western countries. However, the current safe haven status of the UK may continue for some time, tempering any increases in yield.
- This interest rate forecast is based on an assumption that growth starts to recover in the next three years to a near trend rate (2.5%). However, if the Euro zone debt crisis worsens as a result of one or more countries having to leave the Euro, or low growth in the UK continues longer, then Bank Rate is likely to be depressed for even longer than in this forecast.

Interest Rate Forecast

Sector's interest rate forecast is as follows:

	17.9.12 actual	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15
BANK RATE	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75	1.00
3m LIBID	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.70	0.90	1.10	1.40
6m LIBID	0.85	0.85	0.85	0.85	0.85	0.85	1.00	1.10	1.30	1.50	1.80
12m LIBID	1.30	1.30	1.30	1.30	1.40	1.50	1.70	1.90	2.10	2.30	2.60
5yr PWLB	1.89	1.50	1.50	1.50	1.60	1.70	1.80	1.90	2.00	2.10	2.30
10yr PWLB	2.91	2.50	2.50	2.50	2.60	2.70	2.80	2.90	3.00	3.20	3.30
25yr PWLB	4.15	3.70	3.70	3.70	3.80	3.80	3.90	4.00	4.10	4.20	4.30
50yr PWLB	4.32	3.90	3.90	3.90	4.00	4.00	4.10	4.20	4.30	4.40	4.50

The above Sector forecasts for PWLB rates incorporate the introduction of the **PWLB certainty rate** in November 2012 which will reduce PWLB borrowing rates by 0.20% for most local authorities including Portsmouth. The actual PWLB rates on 17.9.12 should therefore to be reduced by 20bps to provide a true comparison to the forecasts.

3. NET DEBT

The Council's net borrowing position at 30 September 2012 was as follows:

	1 April 2012	30 September 2012
	£'000	£'000
Borrowing	361,524	359,848
Finance Leases	5,335	4,918
Service Concession Arrangements (including PFIs)	85,483	84,852
Transferred debt administered by HCC	15,079	14,765
Gross Debt	**467,421**	**464,383**
Investments	(238,637)	(258,409)
Net Debt	**228,784**	**205,974**
LIMIT FOR NET DEBT	**272,053**	**272,053**

The Council has a high level of investments relative to its gross debt due to a high level of reserves, partly built up to meet future commitments under the Private Finance Initiative schemes and future capital expenditure. The £88.6m of borrowing taken in 2011/12 to take advantage of the very low PWLB rates has also temporarily increased the Council's cash balances.

The current high level of investments increases the Council's exposure to credit risk, ie. the risk that an approved borrower defaults on the Council's investment. In the interim period where investments are high because loans have been taken in advance of need, there is also a short term risk that the rates (and therefore the cost) at which money has been borrowed will be greater than the rates at which those loans can be invested. The Government has introduced a 1% mark up between PWLB rates and the gilt rates that are used by the PWLB to set its rates. These loans were therefore taken out at rates that have proved to be very favourable. The level of investments will fall as capital expenditure is incurred and commitments under the Private Finance Initiative (PFI) schemes are met.

4. BORROWING ACTIVITY

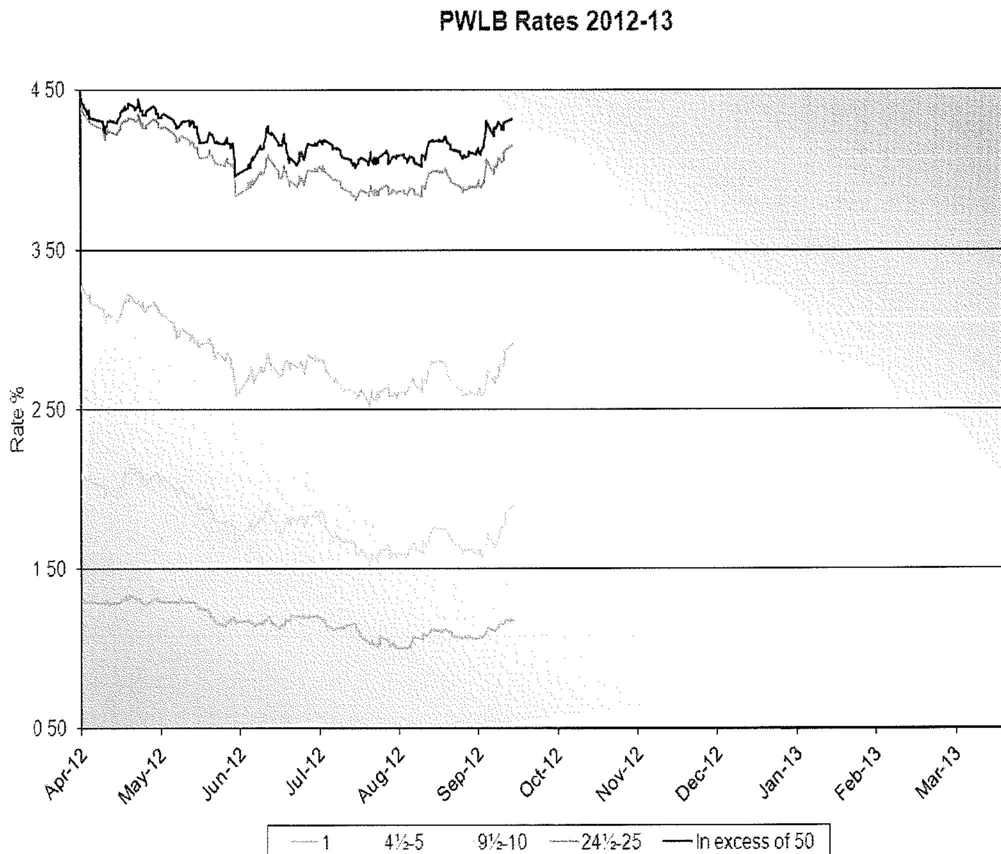
No borrowing has been undertaken in the first six months of 2012/13.

The Council's debt at 30 September was as follows:

Prudential Indicator 2012/13	Limit £M	Position at 30/9/12 £M
Authorised Limit	508	464
Operational Boundary	484	464

It is anticipated that further borrowing will not be undertaken during this financial year.

The graph below shows the movement in PWLB rates for the first six months of the year:



5. MATURITY STRUCTURE OF BORROWING

In recent years the cheapest loans have often been very long loans repayable at maturity.

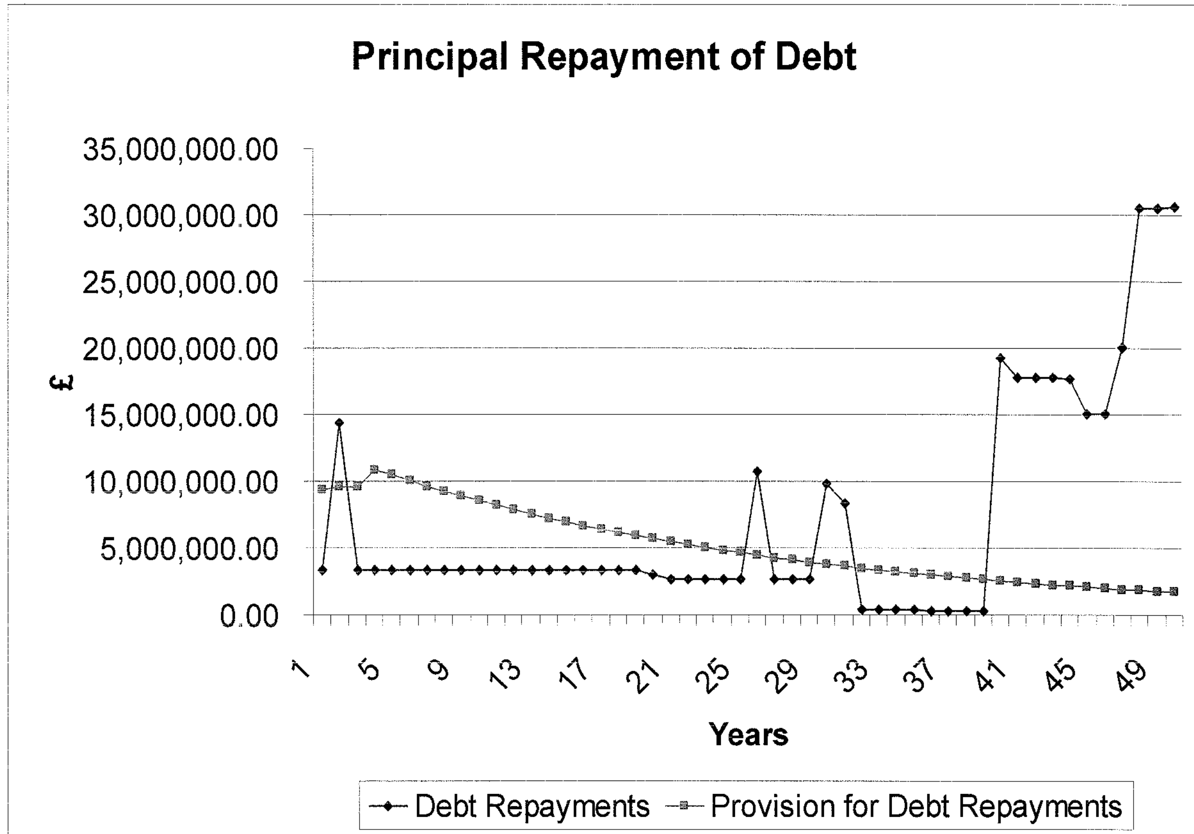
During 2007/08 the Council rescheduled £70.8m of debt. This involved repaying loans from the Public Works Loans Board (PWLB) early and taking out new loans from the PWLB with longer maturities ranging from 45 to 49 years. The effect of the debt restructuring was to reduce the annual interest payable on the Council's debt and to lengthen the maturity profile of the Council's debt.

£50m of new borrowing was taken in 2008/09 to finance capital expenditure. Funds were borrowed from the PWLB at fixed rates of between 4.45% and 4.60% for between 43 and 50 years.

A further £173m was borrowed in 2011/12 to finance capital expenditure and the HRA Self Financing payment to the Government. Funds were borrowed from the PWLB at rates of between 3.48% and 5.01%. £89m of this borrowing is repayable at maturity in excess of 48 years. The remaining £84m is repayable in equal installments of principal over periods of between 20 and 31 years.

As a result of interest rates in 2007/08 when the City Council rescheduled much of its debt and interest rates in 2008/09 and 2011/12 when the City Council undertook considerable new borrowing 58% of the City Council's debt matures in over 40 years time.

The Government has issued guidance on making provision for the repayment of debt which the Council is legally obliged to have regard to. The City Council is required to make greater provision for the repayment of debt in earlier years. Therefore the City Council is required to provide for the repayment of debt well in advance of it becoming due. This is illustrated in graph below.



This means that it is necessary to invest the funds set aside for the repayment of debt with its attendant credit and interest rate risks (see sections 8 and 10). The City Council could reschedule its debt, but unless certain market conditions exist at the time, premium payments have to be made to lenders.

CIPFA's Treasury Management in the Public Services Code of Practice which the City Council is legally obliged to have regard to requires local authorities to set upper and lower limits for the maturity structure of their borrowing. The limits set by the City Council on 20 March together with the City Councils actual debt maturity pattern are shown below.

	Under 1 Year	**1 to 2 Years**	**3 to 5 Years**	**6 to 10 Years**	**11 to 20 Years**	**21 to 30 Years**	**31 to 40 Years**	**41 to 50 Years**
Lower Limit	0%	0%	0%	0%	0%	0%	0%	0%
Upper Limit	6%	6%	18%	30%	60%	60%	60%	80%
Actual	1%	4%	3%	5%	9%	12%	8%	58%

6. INVESTMENT ACTIVITY

In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite. As set out in Section 2, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low and in line with the 0.5% Bank Rate. The continuing Euro zone sovereign debt crisis, and its potential impact on banks, prompts a low risk strategy. Given this risk adverse environment, investment returns are likely to remain low.

The Council held £258m of investments as at 30 September 2012 (£239m at 31 March 2012) and the investment portfolio yield for the first six months of the year is 0.92%.

The Council's budgeted investment return for 2012/13 is £2,212k, and performance for the year to date is £96k above budget.

The Annual Investment Strategy for 2012/13 raised the individual counter party limits from 364 days to 366 days. It was felt that financial institutions may prefer 366 day investments as they are beneficial to them in meeting financial regulations and that this may provide a means of increasing investment returns without significantly increasing credit and liquidity risk. This has proved to be attractive to financial institutions and the Council will have £106m invested for periods longer than 364 days at 31 March 2013 compared to a limit of £110m.

The Council has had difficulty finding sufficient suitable banks and building societies to invest its surplus funds in. Consequently at 30 September 46% of the Council's investments were placed with other local authorities which are currently offering less than 0.5% for investments of a year's duration. The interest rates offered by the Council's current approved counter parties are not expected to increase in the near future.

7. INVESTMENT COUNTER PARTY CRITERIA

It is recommended that the limit on principal sums invested for periods longer than 364 days at 31 March 2013 be increased by £40m from £110m to £150m.

It is recommended that the number of approved institutions where investments can be placed be increased, principally through the inclusion of unrated building societies.

Building societies operate under a separate legal regime to banks, which limits the amount of lending not secured on residential property, limits the amount of wholesale funding, and ranks wholesale deposits, such as the City Council's, higher than individuals' savings in the event of a liquidation. The recent Independent Commission on Banking report has recommended reversing the priority of wholesale and retail deposits by 2019, but the Treasury has indicated that any changes in legislation will not be retrospective.

Building Societies are tightly regulated by the Financial Services Authority, which can detect problems at an early stage and has recently acted to encourage several mergers. In the unlikely event of a building society being forced into liquidation, wholesale investors would almost certainly receive back the full amount of their investment, with any losses falling on the society's reserves and members' deposits first.

The credit ratings of some of the larger societies have been downgraded in recent years, indicating a greater likelihood of default, mainly due to their exposures to non-traditional lending at a time of recession and falling house prices in the UK. Many smaller societies that have been more conservative in their lending approach do not have credit ratings. Building societies' accounts suggest that many of those without credit ratings are arguably in a better financial position than some of the larger ones which hold ratings.

Nineteen unrated building societies and one building society with a single credit rating have been added to the proposed counter party list. These are drawn from the 36 largest building societies, but excluding those with especially large proportions of non-mortgage lending or wholesale funding, and those with particularly low levels of capital or liquidity, compared with the sector average. Building societies rated BBB- or Baa3 and those graded Baa2 on negative watch have been excluded from the proposed counter party list.

It is recommended that the limit applied to the building society sector be increased by £50m from £28m to £78m.

It is proposed to lower the required sovereign rating for the countries where banks are located from AAA to AA+. Two of the three main credit rating agencies have put the UK's sovereign AAA rating on negative outlook so it would be appropriate to lower the required sovereign rating to AA+. The principle effect of this is to include American banks on the approved list of investments.

It is proposed to exclude banks located in the Euro zone from the proposed list of approved investments due to the considerable economic and political uncertainty in the region. Although the countries receiving or likely to require bail outs are confined to the periphery of the Euro zone, further bail outs or stronger measures such as debt guarantees could weaken the core countries that would bear the brunt of financing these.

The recommended revised list of investment counter parties is contained in Appendix B.

The Council requires financial institutions to have a credit rating of at least A- to be included in the list of specified investments. Therefore unrated building societies will be non-specified investments. In addition specified investments must be short term, ie. 364 days or less. Therefore the limits on non specified investments will need to be increased to accommodate these factors. It is therefore recommended that the limit on non specified investments be increased by £90m from £146m to £236m.

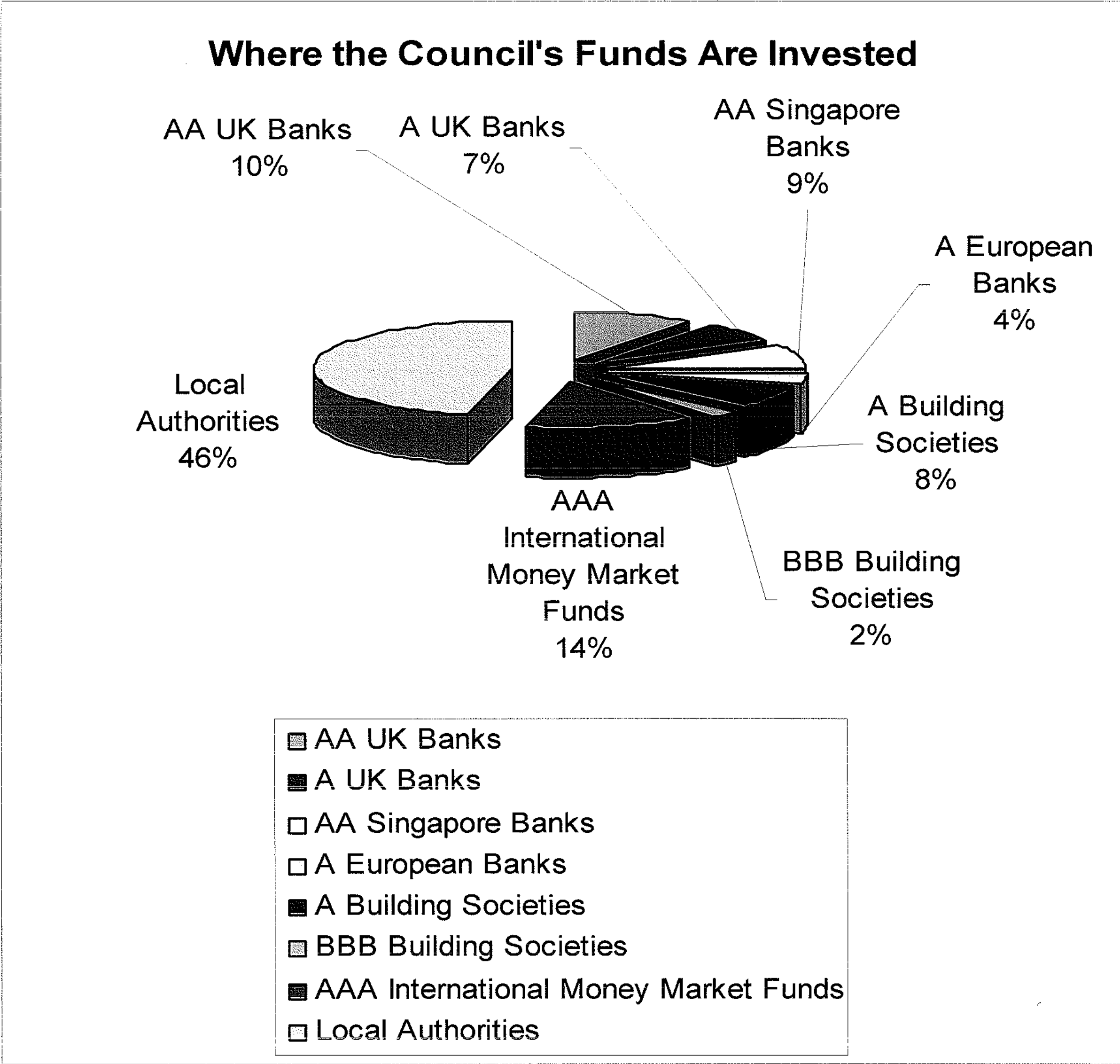
8. SECURITY OF INVESTMENTS

The risk of default has been managed through limiting investments in any institution to £20m or less depending on its credit rating and spreading investments over countries and sectors.

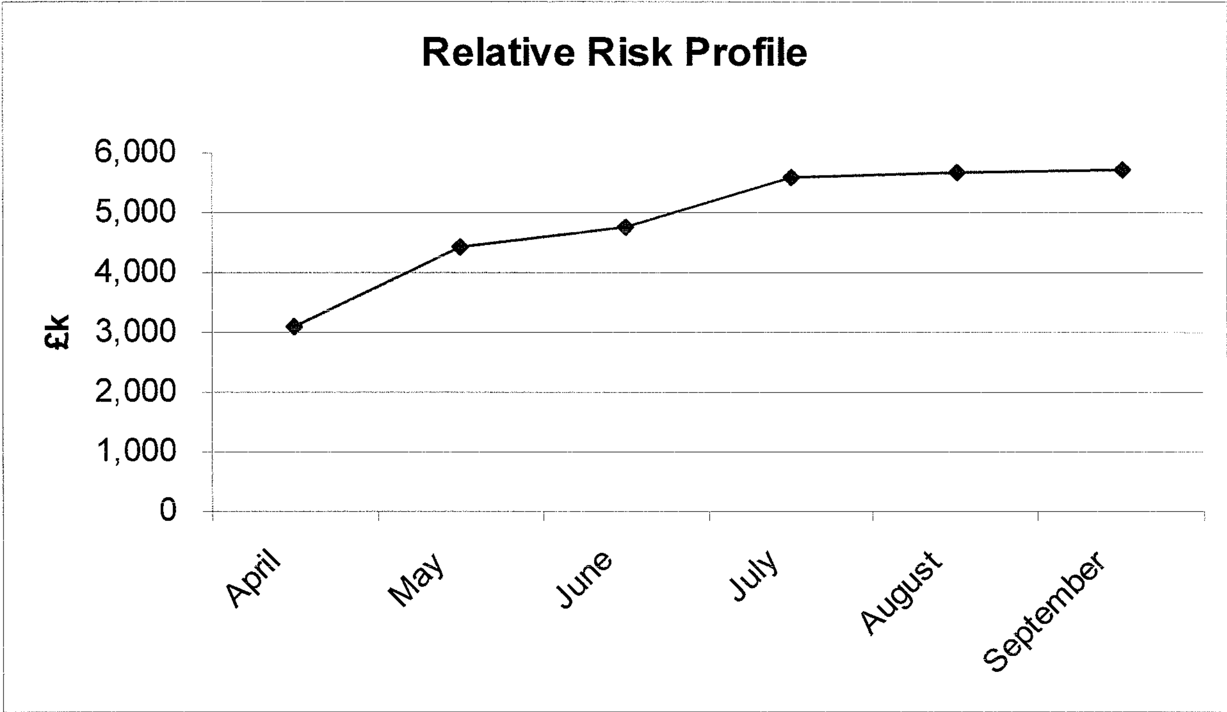
Barclays Bank has been downgraded by the two of the three main credit rating agencies. The rating agencies have expressed concerns about the concentration of risks in global investment banking, and exposure to a weak operating environment in Europe, particularly in Spain and Italy, as well as in the UK together with the probability of government support reducing over the medium term. The rating agencies have also expressed concerns following the resignation of Bob Diamond, the Chief Executive, and the accompanying strategic uncertainty arising from this and other changes to management. The agencies believe that Barclays has been negatively affected by these changes along with the revelations of poor business practices and weak compliance in relation to the past setting of LIBOR rates. Consequently Barclay's investment limit was reduced from £15m to £10m. At 30 September the Council has £12m invested in Barclays. Investments in Barclays will fall below their investment limit on 1 November when a £4m investment matures.

At 30 September 2012 the City Council had on average £8.1m invested with each institution.

The chart below shows how the Council's funds were invested at 30 September2012.



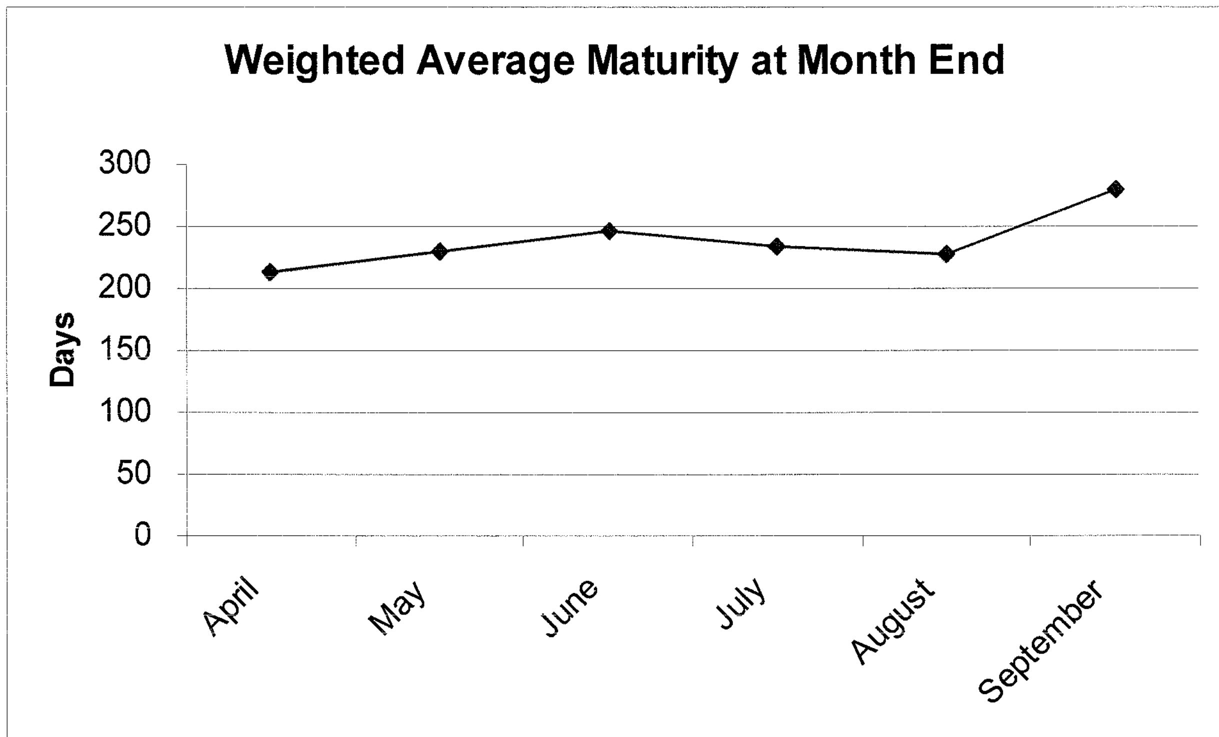
The credit rating agencies publish default rates for each rating category. Multiplying these default rates by the amount invested in each credit rating category provides a measure of risk that can be used as a benchmark to determine whether the City Council's investment portfolio is becoming more or less risky over time as shown in the graph below.



The City Council's investment portfolio became relatively more risky over the first two quarters of 2012/13. This is largely due to much less use being made of AAA rated money market funds that pay relatively low levels of interest. Reducing the use of money market funds is also likely to reduce the Council's exposure to the Euro-zone. The above graph should be read in relative terms. A default occurs when sums due are not paid on time. A default does not mean that the sum invested will be lost permanently.

9. LIQUIDITY OF INVESTMENTS

The weighted average maturity of the City Council's investment portfolio has fluctuated between 212 and 279 days in first half of 2012/13. The maturity profile of the investment portfolio has been lengthened to obtain better rates of return in an economic environment where interest rates are low and are not expected to rise by much before 2014. This is shown in the graph below.



The 2012/13 Treasury Management Policy seeks to maintain the liquidity of the portfolio, ie. the ability to liquidate investments to meet the Council's cash requirements, through maintaining at least £10m in instant access accounts. At 30 September £36.3m was invested in instant access accounts. Whilst short term investments provide liquidity and reduce the risk of default, they do also leave the Council exposed to falling interest rates.

Under CIPFA's Treasury Management Code it is necessary to specify limits on the amount of long term investments, ie. investments exceeding 364 days that have maturities beyond year end in order to ensure that sufficient money can be called back to meet the Council's cash flow requirements. The Council's performance against the limits set by the City Council on 20 March 2012 is shown below.

Maturing after	**Original Limit** £m	**Recommended Revised Limit (See Section 6)** £m	**Actual** £m
31/3/2013	110	150	106
31/3/2014	90	90	35
31/3/2015	80	80	15

10. INTEREST RATE RISK

This is the risk that interest rates will move in a way that is adverse to the City Council's position.

The CIPFA Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes require local authorities to set upper limits for fixed interest rate exposures. Fixed interest rate borrowing exposes the Council to the risk that interest rates could fall and the Council will pay more interest than it need have done. Long term fixed interest rate investments expose the Council to the risk that interest rates could rise and the Council will receive less income than it could have received. However fixed interest rate exposures do avoid the risk of budget variances caused by interest rate movements. The Council's performance against the limits set by the City Council on 20 March 2012 is shown below.

	Limit **£m**	**Actual** **£m**
Maximum Projected Gross Borrowing – Fixed Rate	378	360
Minimum Projected Gross Investments – Fixed Rate	-	(108)
Fixed Interest Rate Exposure	378	252

The CIPFA Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes also require local authorities to set upper limits for variable interest rate exposures. Variable interest rate borrowing exposes the Council to the risk that interest rates could rise and the Council's interest payments will increase. Short term and variable interest rate investments expose the Council to the risk that interest rates could fall and the Council's investment income will fall. Variable interest rate exposures carry the risk of budget variances caused by interest rate movements. The Council's performance against the limits set by the City Council on 20 March 2012 is shown below.

	Limit **£m**	**Actual** **£m**
Minimum Projected Gross Borrowing – Variable Rate	-	-
Maximum Projected Gross Investments – Variable Rate	(378)	(150)
Variable Interest Rate Exposure	(378)	(150)

The City Council is particularly exposed to interest rate risk because all the City Council's debt is made up of fixed rate long term loans, but most of the City Council's investments are short term. Future movements in the Bank Base Rate tend to affect the return on the Council's investments, but leave fixed rate long term loan payments unchanged. This could favour the City Council if short term interest rates rise.

The risk of a 0.5% change in interest rates to the Council is as follows:

Effect of +/- 0.5% Rate Change	**2012/13 (Part Year)** **£**	**2013/14** **£**	**2014/15** **£**	**2015/16** **£**
Long Term Borrowing	1,808	55,000	55,000	55,000
Investment Interest	(83,992)	(770,425)	(861,102)	(883,713)
Net Effect of +/- 0.5% Rate Change	**(82,184)**	**(715,425)**	**(806,102)**	**(828,713)**

APPENDIX B

INVESTMENT COUNTER PARTY LIST

Counterparty Name	Category	Average Long Term Credit Rating *	Comments	Investment Limit £	Maximum Term	Change from 2012/13 Approved Strategy
United Kingdom Government	1	AA+		Unlimited	1,830 days	
All local authorities in England, Scotland & wales	2	A+		20000000	1,830 days	
Svenska Handelsbanken	3	AA-		20,000,000	732 days	
Australia & New Zealand Banking Group	3	AA-		20 000,000	732 days	
Commonwealth Bank of Australia	3	AA-		20,000,000	732 days	
Westpac Banking Corporation	3	AA-		20 000 000	732 days	
Bank Of Nova Scotia	3	AA-		20 000 000	732 days	
Royal Bank of Canada	3	AA-		20 000 000	732 days	
Toronto-Dominion Bank	3	AA-		20 000 000	732 days	
Nordia Bank AB	3	AA-		20 000 000	732 days	
DBS Bank	3	AA-		20 000 000	732 days	
Overseas Chinese Banking Corp	3	AA		20 000 000	732 days	
United Overseas Bank	3	AA		20 000 000	732 days	
Bank of New York Mellon	3	AA-		20,000,000	732 days	New Counter party
Wells Fargo Bank NA	3	AA-		20 000 000	732 days	New Counter party
Inter-American Developmemnt Bank	3	AAA		20 000 000	732 days	
IBRD (World Bank)	3	AAA		20,000,000	732 days	
Global Treasury Funds Plc	3	AAA	Money Market Fund	20 000 000	Instant Access	
Short Term Investment Company (Global Series) plc	3	AAA	Money Market Fund	20,000,000	Instatnt Access	
Goldman Sachs Sterling Liquid Reserve	3	AAA	Money Market Fund	20 000 000	Instatnt Access	
Scottish Widows Investment Partnership Global Liquidity Sterling Fund	3	AAA	Money Market Fund	20 000 000	Instatnt Access	
BNY Mellon Sterling Liquidity Fund	3	AAA	Money Market Fund	20,000,000	Instatnt Access	
Citibank	3	AAA	Money Market Fund	20,000,000	Instatnt Access	
Deutsche Global Liquidity Series Plc	3	AAA	Money Market Fund	20 000 000	Instatnt Access	New Counter party
Standard Life Sterling Liquidity Fund	3	AAA	Money Market Fund	20,000 000	Instant Access	
Standard Chartered Bank	4	A+		15,000,000	366 days	
HSBC Bank plc	4	AA-		20 000,000	732 days	Down graded from category 3
Bank of Montreal	4	AA-	S&P S/Term ratings A1	15 000 000	366 days	Down graded from category 3
Canadian Imperial Bank of Commerce	4	AA-	S&P S/Term ratings A1	15,000,000	366 days	Down graded from category 3
Skandinaviska Enskilda Banken (SEB)	4	A+		15,000,000	366 days	
Swedbank AB	4	A+		15 000 000	366 days	Up graded from category 5
DNB Bank	4	A+		15 000 000	366 days	
JP Morgan Chase Bank NA	4	A+		15,000,000	366 days	New counter party
National Bank of Canada	4	A+	S/Term ratings F1 / A1	15 000 000	366 days	
Barclays Bank	5	A		10 000 000	366 days	Down graded from category 4
Credit Suisse	5	A		10,000,000	366 days	Down graded from category 4
UBS AG	5	A		10 000 000	366 days	Down graded from category 4
Nationwide Building Society	5	A		10 000 000	366 days	
Lloyds TSB	5	A		10,000 000	366 days	Up graded from category 6
Yorkshire Building Society	6	BBB		6 000,000	366 days	
Coventry Building Society	6	A-	Moody's S/Term Rating P2	6,000,000	366 days	
Leeds Building Society	6	A-	S/Term ratings F2 / P2	6 000,000	366 days	
Nottingham Building Society	7	A-	Single rating	4,000,000	366 days	New category
Progressive Building Society	7	Unrated		4,000 000	366 days	New category
Cambridge Building Society	7	Unrated		4 000 000	366 days	New category
Furness Building Society	7	Unrated		4 000 000	366 days	New category
Leek United Building Society	7	Unrated		3 800 000	366 days	New category
Monmouthshire Building Society	7	Unrated		3 700 000	366 days	New category
Newbury Building Society	7	Unrated		3 400 000	366 days	New category
Hinkley & Rugby Building Society	7	Unrated		2 900 000	366 days	New category
Darlington Building Society	7	Unrated		2 700 000	366 days	New category
Marfket Harborough Building Society	7	Unrated		2 200 000	366 days	New category
Melton Mowbray Building Society	7	Unrated		1 900 000	366 days	New category
Tipton & Coseley Building Society	7	Unrated		1 800 000	366 days	New category
Marsden Building Society	7	Unrated		1 700 000	366 days	New category
Hanley Economic Building Society	7	Unrated		1 700 000	366 days	New category
Scottish Building Society	7	Unrated		1 700 000	366 days	New category
Dudley Building Society	7	Unrated		1 600 000	366 days	New category
Loughborough Building Society	7	Unrated		1 400,000	366 days	New category
Mansfield Building Society	7	Unrated		1 400 000	366 days	New category
Vernon Building Society	7	Unrated		1 200,000	366 days	New category
Harpenden Building Society	7	Unrated		1 100 000	366 days	New category
Co-operative Bank plc	8	BBB+	Fitch S/Term Rating F2 Negative Watch Moody's BFSR C- Negative Watch	5,000,000	Overnight / Instant Access	Category renumbered
Total						

Notes

* The long term credit ratings shown are adjusted to take account of possible future actions resulting from negative watches & outlooks All negative watches & outlooks are assumed to result in a one notch downgrade